No. 10356

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

GUARANTY TRUST COMPANY, a corporation, as liquidating trustee of Yakima Holding Corporation,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

and

UNITED STATES OF AMERICA,

Appellant,

vs.

GUARANTY TRUST COMPANY, a corporation, as liquidating trustee of Yakima Holding Corporation,

Appellee.

REPLY BRIEF OF APPELLANT, GUARANTY TRUST COMPANY

UPON APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF WASHINGTON SOUTHERN DIVISION

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ARGUMENT

The position taken by the government in its brief is this: That because the Holding Company participated in a transaction that was ultra vires the Bank's powers, the Holding Company must pay an income tax upon the profits the Bank made, kept and spent.

This is almost the same as contending that each of the officers of the Bank and the Holding Company should have to pay an income tax upon the same profit because they participated in the ultra vires acts which led to the Bank making the profit.

Neither the Holding Company nor the officers were entitled to receive any of the money: neither of them received any of the money.

The entire argument comes to this: The Bank made the profit, but it should not have done so. Therefore we are going to punish the Holding Company for participating in the transaction by arbitrarily assuming that the profit was received by it, even though it is admitted that it neither received nor was entitled to receive, any of the profit.

This remarkable conclusion is solely based upon the contention that because the statute (12 U.S.C.A. 24 (7) contains the following sentence:

> "Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the *purchase* by the association of any shares of stock of any corporation." (Italics supplied)

From this lack of power to *"purchase" stock,* counsel blandly deduce a positive legal prohibition of the "ownership" of any stock.

After making this hurdle, they contend that the Bank could not be the beneficiary of a trust which involved corporate stock. The sole authority to sustain this position being Section 117 of the Restatement of the Law of Trusts and an early California case.

The conclusive answers to this contention are:

(1) The Holding Company bought the stock for the Bank and as the agent of the Bank, and never had any title to the stock whatsoever. The stock never was in its name, nor except in passing within its possession or under its control. The Miller stock was delivered to the Guaranty Trust Company for the Bank and by the Trust Company was delivered to the Bank. The 7500 shares were bought, 5000 shares in the Bank's name and 2500 shares in the name of Bradshaw and were delivered to the Bank, which kept it, and which sold it, received the proceeds and used the proceeds. It was exactly the same as if the stock had been bought for the Bank, and with its money by and in the name of one of the Bank's officers. Regardless of the doctrine of ultra vires, the stock was the property of the Bank. And title vested in the Bank.

36 Yale L. J. 297, 304;
7 Fletcher Corp. (Perm. Ed.) 654-5;
McCandless v. Hoskins, 20 F. (2) 688, 692; Aff. 28 F. (2) 693, 8 Cir.

Schofield v. Baker, 212 F. 504; 221 F. 322.

No one can question the transaction after it was executed, (and here the facts are, and the trial court found, that the transaction was fully executed,) except the sovereign which created the corporation, and then only in direct proceedings in quo warranto or for ouster and forfeiture of the Bank's charter.

7 Fletcher Corp. (Perm. ed.) 651, 669;
7 Fletcher Corp. (Perm. ed.) 658-60;
Kerfoot v. Farmers & Merchants Bank, 218 U.S. 281;

Even where a statute directly forbids the acquisition of the property, the title vests subject only to proceedings in the nature of quo warranto.

7 Fletcher Corp. (Perm. ed.) 666-8;
7 Fletcher Corp. (Perm. ed.) 669.

The statute does not impliedly nor expressly forbid a National Bank from "owning" corporate stock—it is only not granted the powers to "purchase" corporate stock. It is perfectly proper for it to loan money and take corporate stock as collateral security and, upon forfeiture, to become the owner to save itself from loss, it may receive such stock as a gift or bequest.

It is, however, an ultra vires act for it to buy the stock, but after it has bought the stock, it owns the stock and may receive the dividends upon it, vote it and sell it.

Section 117 of the Restatement of Trusts refers only

to those cases where there is an absolute lack of capacity to *own,* regardless of the method of acquiring title.

The comment quoted on page 37 of the answer brief in the first place is in reference to land only, and in the second place clearly recognizes the doctrine of ultra vires, set forth above, that the trust is good until directly attacked by the sovereign in quo warranto proceedings.

The Supreme Court said in *Kerfoot v. Farmers* N *Merchants Bank,* 218 U.S. 281, 286, that an ultra vires purchase of real estate vested title in the National Bank, and that the Bank's buying the property,—

> "only lays the bank open to proceedings by the government for exercising powers not conferred by law."

In *Union Nat. Bank v. Matthews,* 98 U.S. 621, the court held in reference to an ultra vires purchase of property:

> "It is valid until assailed in a direct proceedings instituted for that purpose."

Thompson v. St. Nicholas National Bank, 146 U. S. 240, 247, 252;
Logan Co. Nat. Bank v. Townsend, 139 U.S. 67, 77;
National Bank of Genesee v. Whitney, 103 U.S. 99.

In *Cleveland C. C. & St. L. R. Co. v. U. S.* 275 U.S. 404, 414, the court citing the Kerfoot case, supra, said:

> "If the state concludes to question the legality of the shippers' acts, it must do so in a direct proceedings instituted by it for that purpose."

Against these authorities the government refers to an inadvertent statement on page 36 of our opening brief

where the word "own" was used, when it should have been "buy" or "purchase", and the whole tenor of the brief so shows, and several cases (page 26 of answer brief) all of which are in reference to cases where a National Bank had been sued upon an ultra vires contract in an attempt to enforce the ultra vires contract against the bank. Those cases simply hold that the bank can defend against an unexecuted ultra vires contract.

The case of *Awotin v. Atlas Exch. Nat. Bank,* 295 U.S. 209, is explained and distinguished from a case such as this in *Oppenheimer v. Harriman Nat. Bank,* 301 U. S°. 206, 211, as follows:

> "But that decision does not support its contention. There the bank sold bonds and in connection with the sale agreed with the buyer that at maturity it would repurchase at par value and accrued interest. We held the agreement repugnant to § 24 (Seventh) requiring sales to be without recourse. The sale was a valid executed contract; the bank's *promise* to repurchase was forbidden by law and therefore void. The purchaser, chargeable with knowledge of the statute, could not invoke estoppel."

The 8th Circuit in *Jackman v. Continental Nat. Bank,* 16 F. (2d) 728, reviews the other cases cited and shows their inapplicability.

In the Oppenheimer case the court, citing *Lantry v. Wallace,* 182 U.S. 536 (quoted on page 59 of our opening brief) and most of the cases cited by us above, said:

> "The bank had power to sell the stock in question whether acquired by it in accordance with or contrary

to § 83, and whether the stock belonged to it, the affiliate or a third party."

Here as we stated above, the government is seeking to impose a penalty or punishment upon the Holding Company for participating in a transaction which was ultra vires as to the Bank. This we believe cannot be done.

In *Union National Bank v. Matthews,* 98 U.S. 621, 629, quoted with approval in *Scott v. DeWeese,* 181 U.S. 202, 211, the Supreme Court said in reference to the limit of possible punishment for an ultra vires transaction:

"The impending danger of a judgment of ouster and dissolution was, we think, the check, and none other, contemplated by Congress. That has been always the punishment prescribed for the wanton violation of a charter, and it may be made to follow whenever the proper public authority shall see fit to invoke its application."

Also quoted and cited with approval:

American Surety Co. v. Moran, Dist. Ct. of App., 75 F. (2) 646, 647;
Schneider v. Thompson, 8 Cir. 58 F. (2d) 94, 99.

Another answer to the government's position is the Baker v. Scofield litigation which arose in this circuit.

Scofield v. Baker, D.C. 212 Fed. 504;
Baker v. Scofield, 9th Cir. 221 Fed. 322;
Baker v. Scofield, 243 U.S. 114.

In that litigation a trust was imposed upon real estate in favor of a national bank. That is, the bank was the beneficiary.

This court said (221 Fed. at 326):

> "It may be conceded that the contract was ultra vires. But its invalidity by reason of the fact that it was ultra vires cannot be interposed by the defendants as a defense to a suit of this character."

The court then cites the quotes from *Union National Bank v. Matthews,* 98 U.S. 621, including the quotations above, and other cases. The Supreme Court affirmed.

Those cases constitute conclusive authority for the proposition that, if the Holding Company had secured possession of the Sunshine stock, the Bank could have a resulting trust established and recovered the stock, and if it had been sold, all of the proceeds of the stock.

Here it was found by the court and established by the uncontradicted evidence, that the Holding Company was the agent of the Bank to buy the Sunshine stock.

If the Holding Company had taken title of the stock in its name, it would have been liable as, and subject to all the duties of a trustee.

2 Restatement, Agency, § 423.

But here the Holding Company did not take title in its own name; it never had a single share in its name.

5000 shares were bought in the name of the Bank. It is the uncontradicted evidence that the bank was the owner of the stock. After it was bought in the Bank's name the stock was delivered to the Bank; later the Bank sold the

stock and received all the proceeds and used part of those proceeds to pay its debt to the Holding Company. Upon what theory the trial court construed that purchase to be one by the Holding Company in its own behalf we are unable to speculate.

2500 shares were bought in the name of George Bradshaw, who was an officer of the Bank and of the Holding Company. He signed and delivered the letter (Ex. 191, Tr. 47, 315) stating that that stock was bought for the Bank. He endorsed the certificate, delivered the certificate to the Bank, later the Bank sells the stock, receives the proceeds, uses the proceeds, using part to pay it indebtedness to the Holding Company. Upon what fact the trial court based its conclusion that this purchase was by and for the Holding Company does not appear.

All we know is that he concluded that the above transactions were for the account of the Holding Company, and this in face of his express holding that the agreement (Ex. 19) "was executed and delivered on December 12, 1934, *and was performed.*" (Finding 12, Tr. 490)

The 5000 shares of Miller stock was delivered by Miller to the Guaranty Trust Company, which in turn delivered the shares to the Bank; the Bank sold 3500 of the shares; paid Miller for the shares out of the proceeds (Tr. 491) and kept and used all of the balance. The 1500 shares of stock were retained by the Bank until later, when it sold those shares and kept and retained all of the proceeds.

That the government's position based upon § 117 of the Restatement is wholly fallacious is clearly shown by the leading authorities on the law of trusts.

In *1 Bogert, Trusts* N *Trustees,* § 168 p. 492-493 the author says.

> "If the acceptance of the beneficial interest by the cestui corporation would be merely ultra vires, the disposition of the courts is to treat the trust for the corporation as valid and enforceable by the cestui against the trustee, but subject to attack by the state or the stockholders."

See also *1 Scott on Trusts,* § 117.1 p. 590.

Further, no one, not even counsel in this case, has ever contended that bank could not perform an ultra vires act, and no one has ever contended that its agents could not assist it in the performance of an ultra vires act.

All that the Holding Company ever did was to act as the Bank's agent in buying the stock for it.

7 Fletcher Corporations (Perm. Ed.) § 580.
Lucas v. Earl doctrine.

On pages 28 to 33 the government interjects the doctrine of the cases of *Lucas v. Earl,* 281 U.S. 11 and *Helvering v. Horst,* 311 U.S. 112. These cases hold, and only hold, that, where "A" who wholly owns, controls and possesses an asset—personal services in the Lucas case and bonds in the Horst case—assigns or transfers all or a part of the income from that asset, while still retaining full ownership, control

and possession of the asset, to "B", the income from the asset is to be taxed to "A", the owner of the asset.

In Blair v. Commissioner, 300 U.S. 5, the Supreme Court held:

> "The one who is to receive the income as the owner of the beneficial interest is to pay the tax."

The evidence upon this question is clear and unimpeached and uncontradicted.

The Bank in August 1934 bought 7500 shares of Sunshine stock. (R 93, 101, 108, 114, 119, 128, 156, 170, 171, 172).

The 5000 share purchase which was made in the name of the Bank was handled by R. M. Hardy. (R 93-4, 135)

The Bank directed Mr. Bradshaw to buy the 2500 shares which were taken in his name. (R 95)

All of the 7500 shares of stock was kept in Mr. Hardy's possession for the Bank. (R 96)

In the letter and written agreement of December 12, 1934, (R 484) it is clearly stated that the 7500 shares and the 5000 shares of Sunshine were purchased for and held for the Bank. That the stock belonged to the Bank. And the court held that the agreements referred to in the letter were "performed." (R 490)

Under the record there can be no question but that the stock and the proceeds of the sale of the stock cannot be taxed to the Holding Company. It had no interest therein.

Comm. v. O'Donnell, 9 Cir. 90 F. (2) 907
U. S. v. Spalding, 9 Cir. 97 F. (2) 701, 704.

We respectfully submit that the decree of the lower court should be affirmed upon the appeal of the government and reversed with instructions to enter judgment for the Guaranty Trust Company, upon its appeal in the full amount sued for, $26,933.86 with 6% interest from May 27, 1938.

Respectfully submitted,

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